

# **Operational Review Task Force**

## **Banking Services**

### **November 12, 2010**

#### **Overview**

The Governor's Task Force for the Operational Review of the Commonwealth's Usage of Banking Services was charged with identifying the total spend for banking services, best practices, and proposing strategies to realize cost savings in the State of Virginia's banking operations. While a few banking operations are carried out by individual state agencies, the Department of Treasury (Treasury) is responsible for most of the state's banking services. As a result, much of the Task Force's review focused on Treasury operations.

#### **Total Spend**

In FY 2010 total spend for banking services was \$3.8 million, down from \$4.2 million in FY 2009 and \$4.4 million in FY 2008. This represents the total spend for all Treasury banking services, including Treasury's concentration banks as well as regional banks. This decline in spending occurred within the context of an increase in the number of disbursements and receipts.

#### **Best Practices**

The Task Force determined that the most significant and relevant best practices for banking services are: 1) the coordination of management of banking services in the hands of one entity serving all the interest of the state, and 2) the substitution of electronic transactions for check-based transactions. This is particularly the case for disbursements as the relative difference between the two payments types can be in the area of \$.63 per transaction (Treasury's variable cost per check mailed) compared to generally just a few cents per transaction for receipts. Electronic payments can be in the form of Electronic Data Interchange (EDI), Automated Clearing House (ACH), wire transfers and credit cards.

#### **Proposed Strategies for Adopting Best Practices**

##### ***Disbursements***

The Task Force notes that Treasury has a history of adopting the latest and most efficient methods of managing state banking services, achieving significant economies of scale. The Task Force also finds that Treasury, in concert with state agencies and its competitively chosen banking partners, has already made major strides in adopting electronic payments for both disbursements and receipts. For example, since 2003 the Commonwealth has reduced disbursements by check from 10 million to 3 million checks. In FY 2010, 83% of all disbursements were made electronically, up from 78% the prior

year. Some agency figures are much higher than this average as VEC, DSS, Payroll and VRS which together represent 77% of all Commonwealth disbursements, make more than 90% of their payments electronically. The Task Force finds that the greatest additional progress can be made in general warrant disbursements and, to lesser degree, in tax refunds.

Currently, 47% of general warrant disbursements are made electronically and the Department of Accounts (DOA) has made significant progress in transitioning to electronic payments through the usage of the small purchase charge card program as a substitute for payment by check. However, there are notable hurdles to further improving general warrant electronic disbursements administered centrally by DOA. In particular, DOA cannot currently meet the statutorily permitted requirement to process electronically payments made more than six times annually to the same vendor. According to DOA, its current level of staffing resources is inadequate to process the necessary paperwork required to enroll the extremely high volume (i.e. more than 20,000) of vendors who receive more than six payments annually in the EDI system. In the near term, DOA is focusing enrollment efforts on vendors who receive more than 300 payments annually. In the longer term, DOA is examining the feasibility of outsourcing these processes to a third party provider. The Task Force supports this long-term approach and recommends that DOA's review of this opportunity continue.

Currently, 48% of tax refunds are paid electronically. One reason this number is not higher is the reluctance of individual filers to adopt this choice of payment, despite the Department of Taxation's (TAX) promotional efforts. The Task Force recommends that these promotional efforts should be intensified and to stress the extended time it takes to process a paper return versus an electronically filed return and the resulting refund. Another reason this number is not higher appears to be tied to Tax Preparers underutilizing electronic refunds as compared to the general public. Further analysis into why a significant number of electronic refunds are not being issued from the Tax Preparer community is recommended. If these efforts are unsuccessful, it may be worthwhile to explore monetary incentives to encourage the tax filer to embrace electronic refund delivery.

While the per-transaction price advantage of converting to electronic payments is clear, it is difficult to quantify expected savings. This is especially true for disbursement conversion. For example, it appears progress can be made in increasing DOA's electronic payments largely through outsourcing the creation and retention of documents. The cost of outsourcing is unknown at this point but it may have an impact on savings. With respect to tax refund savings, it is difficult to project what the cost will be of inducing more citizens to choose electronic means; both added promotional activity and/or some sort of monetary incentive are probably necessary to really move the needle. These costs cannot yet be estimated. For both agencies, and in fact for all payments, there is also the issue of retaining some fixed cost to provide checks up to the point of 100% conversion. In light of the sure but difficult to project savings for both receipts and disbursements, the Task Force recommends further studies to determine realistic savings accruing from incremental to total conversion.

### ***Receipts***

Historical volume data for receipts is not as readily available as it is for disbursements. This is in part due to the distinction between receipts processed directly by Treasury, for

which the collection data exists, and those processed by agencies at regional bank branches, for which the summary data is unavailable.

Given the lower cost effectiveness per transaction of using eCommerce for receipts, the need to convert from checks is less striking than it is for disbursements. While the actual banking costs for receipts processed through credit or debit cards are more expensive than receiving funds by check, the state has found many advantages conferred by card processing that are worth the additional cost. These advantages include lower agency processing costs, more timely receipt, greater interest income, better remittance data leading to more efficient posting and certainty of payment resulting in fewer returns. The Commonwealth processed 16 million credit card transactions in calendar year 2009. The Task Force recommends the state continue to promote card based payments made for licenses, fees, fines and other payments.

The Task Force finds agencies have different methods of collecting receipts and have steadily increased usage of electronic means for receiving payments. For example, in FY 2010 DSS received 54% of its receipts electronically, the result of an ongoing initiative to move to electronic means. Since this initiative began, DSS has been able to reduce staffing in its State Disbursement Unit from 75 employees to 38, a 49% decline. All agencies have undertaken efforts to increase receipts electronically and should be further encouraged to adopt eCommerce methods of receipt of funds wherever possible.

## **Conclusion**

The Task Force finds that the decline in total spend for banking services demonstrates that the Commonwealth has realized considerable savings by competitively negotiating bank services, monitoring banking fees to ensure compliance with contracts, and steadily converting to electronic based transactions for disbursements and receipts. The Commonwealth has already adopted best practices in banking operations, particularly with respect to electronic methods of disbursements and receipts. This is the result of a combined effort by Treasury and various agencies to expedite and streamline disbursements and receipts. It is also the result of Treasury working closely with the banking community to identify and adopt best practices at the lowest possible cost to the Commonwealth. The Task force also finds great progress in consistently extending eCommerce payment means. As noted above, there are some opportunities to enhance this process. The Task Force finds that further savings will be realized by increasing eCommerce methods. However, it is premature at this point to estimate the dollar value of these savings as further study of net costs and benefits is required.